

FTB issues tax relief for California fire victims

Taxpayers living in the presidentially declared disaster areas affected by the Southern California wildfires will be given special tax relief.

“Californians living in these fire-ravaged areas need our help,” said State Controller Steve Westly.

“Due to the wildfires, we are delaying all tax billings and notices scheduled for

mailing to affected taxpayers in these counties. We will provide copies of lost or damaged tax returns at no cost and expedite refunds.”

The counties of Riverside, Los Angeles, San Bernardino, San Diego, and Ventura are designated as federal disaster areas.

The IRS announced that taxpayers

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Abusive tax schemes

California offers tax shelter investors a chance to come clean and avoid penalties

This article is the fourth in our series on abusive tax schemes.

California recently enacted new laws aimed at enhancing our ability to pursue and penalize abusive tax scheme investors, promoters, and organizers. Senate Bill 614 and Assembly Bill 1601 gives us the tools to reduce the attractiveness of investing in an abusive tax shelter or transaction in the future and also provides a limited window of opportunity for taxpayers to come forward in order to avoid penalties and potential prosecution.

Abusive tax avoidance transactions are plans or arrangements devised for the principal purpose of avoiding tax.

We will operate a voluntary compliance initiative program beginning January 1, 2004, running through April 15, 2004. If you have clients who used abusive tax shelters or transactions to underreport their state tax liabilities in tax years beginning before January 1, 2003, please let them know about this program.

To participate they must file amended returns during the above period reporting all income and loss without regard to abusive tax shelters or transactions and pay the tax and interest.

We will not impose any penalties or bring criminal action against taxpayers regarding their use of abusive tax

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Tax News

Volume 03-6 November/December 2003

TAX NEWS is a bimonthly publication of the Communications Services Bureau, California Franchise Tax Board. Its primary objective is to provide information to income tax practitioners about state income tax laws, regulations, policies and procedures.

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State offers tax shelter investors one chance to come clean

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shelters or transactions for those tax years the taxpayer participates in the initiative.

Taxpayers can choose one of two options:

- 1 Voluntarily comply without appeal rights.
- 2 Voluntarily comply with appeal rights.

Under the first option, the abusive tax shelter or transaction issue is closed without further dispute. We will not pursue penalties and taxpayers may not subsequently file a claim for refund for amounts paid under the initiative. Under the second option, taxpayers retain their right to file a claim for refund; however, they remain subject to the accuracy related penalty and have certain restrictions regarding when they can file an appeal regarding their claim.

Your clients, including those under examination, may participate in the initiative to resolve their tax shelter issues.

For more information on our voluntary compliance initiative, go to our *Abusive Tax Shelters and Transactions* Webpage at www.ftb.ca.gov. Or search our Website by using the keywords *voluntary compliance*.

In addition to the Voluntary Compliance Initiative discussed above, Senate Bill 614 and Assembly Bill 1601 provide for the following:

- A 40 percent penalty on understatements from transactions lacking economic substance effective for notices issued on or after January 1, 2004.
- A 30 percent penalty on understatements from undisclosed

reportable transactions effective for tax years beginning on or after January 1, 2003.

- A penalty equal to 100 percent of the accrued interest on deficiencies related to tax shelters effective for notices issued on or after January 1, 2004.
- Extends the statute of limitations to eight years for taxpayers to receive a deficiency notice regarding tax shelters (For tax years 1999 and subsequent).
- Prohibits the suspension of interest on deficiency assessments mailed to taxpayers with taxable income greater than \$200,000 and contacted regarding an abusive tax shelter.
- Expands the department's ability to issue subpoenas to taxpayers involved in abusive tax schemes.
- Expands the rules to obtain an injunction against abusive tax shelter promoters from marketing the shelter within this state.
- Conforms to federal disclosure requirements for reportable transactions.
- Establishes reporting, registration, and return disclosure requirements for investors, promoters, tax advisors, and tax preparers involved in abusive tax shelters and transactions.
- Establishes penalties for failing to report, register, or disclose on a return required information regarding abusive tax shelters and transactions.
- Establishes a 50 percent penalty on the gross income promoters derive from promoting tax shelters.
- Requires organizer involved with selling listed transactions to taxpayers after February 28, 2000, and before January 1, 2004, to register those transactions and provide us with a list of the investors by April 30, 2004.

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Tax relief for fire victims

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impacted by the disaster who have tax returns or payments due on or after October 21 through December 29, 2003, are granted an automatic extension through December 29. California honors federal extension periods.

Since the wildfires occurred after the state's October 15 extended filing due date, and the next estimated tax payment is January 15, 2004, only taxpayers who file with a fiscal year end should be affected by the extension period.

Other special tax rules apply to disaster losses. Taxpayers can claim a disaster loss in the tax year the disaster occurred (on the 2003 tax return that taxpayers will file next spring) or in the tax year before the disaster occurred

(by amending the 2002 tax return filed earlier this year). The advantage of claiming the disaster loss in the prior year is that we can quickly issue a refund.

Taxpayers claiming the disaster loss should write, *CA Wildfires*, in red ink at the top of the tax return to alert us to expedite the refund. If e-filing, be sure to follow the software instructions to enter the disaster information.

Taxpayers needing copies of lost or damaged state returns should complete Form FTB 3516, *Request for Copy of Tax Return*. Disaster victims receive copies of tax returns for free. Print *CA Wildfires* in red at the top of the request. For the latest information regarding the wildfires, please check our Website at www.ftb.ca.gov.

FTB to mail notices to nonfilers

This December we will mail over 200,000 notices to people we think should have filed their personal income tax returns for the 2002 tax year.

These notices are based on income information received from sources such as banks, financial institutions, the Employment Development Department and the Internal Revenue Service.

The notice advises individuals that we are unable to locate their tax return under the name and social security number listed.

Remember, if you have a valid Power of Attorney on file with us that covers the 2002 tax year, we will automatically send you a copy of your client's original notice.

The quickest way to respond to our notices is to log on to our public Website (www.ftb.ca.gov/INC), or call our Interactive Voice Response phone system at (866) 204-7902. Both of these options allow you to request more time, resolve problems, and obtain information and forms.

You may also ask questions or provide information to us by using the email feature on the Website.

Our Website and Interactive Voice Response phone system are both available seven days a week, 24 hours a day for your convenience.

You may also respond to our notices by writing or sending a fax. Instructions for both these options are printed on the notices.

Ask the Advocate



Debbie Newcomb
Taxpayer
Advocate

Q: You no longer offer the CD-ROM version of the California Package X. Why?

A: In 2002 we stopped producing the CD-ROM version of the Package X and instead focused on providing high quality forms on the Internet. We stopped because the CD-ROM, while popular with some tax professionals, had several significant disadvantages, and the demand for it has steadily declined over the years.

Using surveys and focus groups, we asked practitioners about how they obtained our forms. We learned that tax practitioners are increasingly going to our Website to get forms and using the printed version of the Package X as a historical or reference document only.

Our Website, www.ftb.ca.gov, remains your best source for approved Franchise Tax Board forms and publications. It is free and always available. We take every step possible to ensure that our online forms, publications, and instructions are always current. When we find an error we can update it within 24 hours. Neither the CD-ROM, nor the printed version can match that type of effectiveness.

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California and IRS partner to crackdown on illegal tax schemes

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The Franchise Tax Board and the Internal Revenue Service signed a memorandum of understanding in September 2003 to detect, audit, and prosecute tax evaders involved in illegal and abusive tax shelter schemes.

“California loses hundreds of millions of state tax dollars each year as a result of these sophisticated tax schemes,” said State Controller Steve Westly.

“This is legitimate tax money owed to the State of California that funds our schools, helps our elderly, and fuels our emergency and transportation services. With a record deficit currently plaguing our state, we are very motivated to pursue these cases,” added Westly.

We have seen an increase in abusive tax schemes in the past few years. The federal government says it loses billions of federal tax dollars each year because of abusive tax scheme deductions.

We estimate California lost as much as \$2 billion in state tax money in the last four years.

The memorandum of understanding outlines a plan where we share leads with the IRS, use our collective tax data bases to detect and track offenders, and increase our collective audit reach to bring offenders into compliance.

The IRS defines abusive tax schemes as transactions that offer tax benefits with no meaningful change in the taxpayer’s control over or loss of their income or assets. These transactions typically have no economic purpose other than reducing taxes, and use multiple layers of domestic and foreign pass-through entities such as partnerships, S corporations, and limited liability companies to hide the transactions.

Abusive tax schemes also include using offshore banks to issue debit/credit cards, providing account owners with

cash equivalent benefits with the perceived opportunity to avoid reporting the related increase in wealth for income tax purposes.

FTB launches *Abusive Tax Scheme* Webpage

We now have a Webpage dedicated to abusive tax schemes information. The Webpage includes technical information, educational articles, answers to frequently asked questions, information on pending legislation, links to related Internal Revenue Service Webpages, and a phone number for taxpayers to call to report suspected abusive tax schemes or investors in abusive tax schemes.

The link is located in the *Quick Links* section of our Website, www.ftb.ca.gov, or you can search our Website using the keywords *abusive tax schemes*.

Ask the Advocate

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Q: You said you would provide an opt-out form for tax practitioners affected by the mandatory e-file law to use to record the reason why a return that was eligible to be e-filed was not. How do I get this form?

A: You can find the Form FTB 8454, *e-file Opt-Out Record*, by clicking on the Mandatory e-file link and going to *e-file Opt-Out Record* link. Please note that Form FTB 8454 is for your

Tax Practitioner Services

Tax Practitioner Hotline

Telephone (916) 845-7057
Fax (916) 845-6377

Personal Income Tax Collection

Fax (916) 845-0494

Business Entities Collection

Fax (916) 845-0145

FTB e-file Help Desk

Telephone (916) 845-0353

convenience and not a required form. All you need is your clients’ signed statements indicating their election not

to e-file their return. Please remember to keep the statements or Forms FTB 8454 in your clients’ files.

Laws and Legislation

Summary of Legislation signed into law in 2003

Several legislative measures affecting the Franchise Tax Board were signed into law. We have summarized them below. If you want to learn more about a legislative measure you read about here, go to our *Law and Legislation* Webpage located on our Website, www.ftb.ca.gov. You can also find comprehensive information about all legislative measures on the Internet at www.leginfo.ca.gov, the Official California Legislation Information Website.

Abusive tax shelters

AB 1601 (Frommer) Stats. 2003, Chapt. 654, SB 614 (Cedillo) Stats. 2003, Chapt. 656

This act:

- Creates a regime of penalties and reporting requirements for investors, promoters, tax advisors, and tax preparers involved in abusive tax shelters to identify existing abusive tax shelter transactions on tax returns filed in prior years and to curtail the use of abusive tax shelters in future years.
- Provides for a voluntary compliance initiative permitting a taxpayer to file an amended return and pay the tax and interest associated with the abusive tax shelter.
- Extends the statute of limitations for taxpayers involved in abusive tax shelters from four to eight years.
- For taxpayers involved in an abusive tax shelter, expands the department's ability to issue a

subpoena.

- Expands the rules to obtain an injunction against abusive tax shelter promoters from marketing the shelter within this state.
- Imposes interest on deficiencies mailed to taxpayers with taxable income greater than \$200,000 and involved in an abusive tax shelter.

Expatriate corporations

SB 640 (Burton) Stats. 2003, Chapt. 657

This act creates the *California Taxpayer and Shareholder Protection Act of 2003*.

Provisions of this act:

- Prohibit the state from entering into contracts with expatriate corporations or their subsidiaries, as defined,
- Allow the executive officer of a state department or agency (or a designee) to waive the prohibition if the contract is necessary to meet a "compelling public interest," as defined.
- Require each vendor (not receiving a waiver) submitting a bid or contract proposal to self-certify that it is an eligible vendor with:
 - 1) The contracting agency for calendar year 2004, and
 - 2) The Department of General Services for calendar year 2005 and thereafter.
- Permit contracts with corporations that expatriated before January 1,

2004, if that corporation provides shareholders with enumerated rights, and agrees to calculate state income tax liability using worldwide combined reporting.

- Apply to corporations that expatriated before January 1, 2004, for contracts entered into on or after April 1, 2004.

Regulated Investment Companies

SB 103 (Alpert) Stats. 2003, Chapt. 655

This act explicitly denies corporate shareholders of a regulated investment company (RIC) a dividend deduction for earnings in a RIC that are not from stock dividends for taxable years beginning on or after January 1, 2003. Legislative intent language prohibits any inference from being drawn from the operative date of the amendments made by this act with respect to any matter governed by the RIC provision of the Revenue and Taxation Code for taxable years beginning before January 1, 2003. Thus, this act allows taxpayers previously taking this deduction to challenge the department's denial of this deduction for taxable years beginning before January 1, 2003.

Conformity

AB 967 (Chavez) Stats. 2003, Chapt. 268

This act does the following in regard to S Corporations:

- Provides that the termination of S corporation status resulting from having passive investment income

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Laws and Legislation

Continued from page 5

exceeding 25 percent of gross receipts only applies at the state level if it applied at the federal level and the federal S status was terminated.

- Removes the state language prohibiting a financial S corporation from using the reserve method for bad debts (thus, conforming to the federal rule by reference) and adds language prohibiting an S corporation from using the reserve method for bad debts. (Thus, not permitting a separate reserve method election at the state level that would trigger a state-only termination of S status.)
- Makes numerous amendments removing obsolete language, mostly transitional or effective date language going back as far as when California first recognized S corporations in 1987 and makes clerical adjustments, such as inserting *income tax* into the phrase *federal purposes*.

This act does the following in regard to estimated tax payments:

- Requires that alternative minimum tax be included in the computation of the required estimated tax payments in order to meet a safe harbor from the underpayment of estimated tax penalty.

This act does the following in regard to disability trusts:

- Increases the credit for disability trusts from one dollar to an amount equal to the personal exemption credit for single individuals. For the 2002 taxable year the single individual personal exemption credit was \$80. The credit is annually adjusted for inflation. This act, in essence, conforms to the *Victims of Terrorism Tax Relief Act*

provision by allowing the state equivalent personal exemption credit to disability trusts.

Court-ordered debt collection

AB 1752 (Assembly Budget Committee) Stats. 2003, Chapt. 225

With respect to child support collections administered by the Franchise Tax Board, this act makes various changes to the laws regarding the information obtained through the Financial Institution Data Match System.

SB 940 (Escutia) Stats. 2003, Chapt. 275

This act allows the Judicial Council to develop a collection amnesty program after consultation with the Franchise Tax Board regarding its court-ordered debt collection program.

The amnesty program will include that some or all of the interest or collection costs imposed on fines and other amounts may be waived if the remaining amounts due are paid within the amnesty period.

Domestic partners

AB 205 (Goldberg) Stats. 2003, Chapt. 421

This act gives registered domestic partners the same community property rights that are granted to and imposed upon spouses in a civil marriage.

In addition, this act specifies that a domestic partner shall use the same filing status for state income tax purposes that was used or would have been used for federal income tax purposes.

Further, this act specifies that earned income may not be treated as

community property for state income tax purposes for a domestic partner.

e-file

AB 1756 (Assembly Budget Committee) Stats. 2003, Chapt. 228

This act requires that all individual returns prepared by tax practitioners that prepare more than 100 individual income tax returns in a calendar year must be electronically filed (e-filed) with the Franchise Tax Board beginning with the following calendar year.

Franchise Tax Board sponsored legislation

AB 1742 (Assembly Revenue and Taxation Committee) Stats. 2003, Chapt. 455

(The Franchise Tax Board sponsored the first three provisions.)
This act:

- Renumbers the tax law code section for the Golden State Scholarshare Trust,
- Simplifies the computation of interest on erroneous refunds.
- Clarifies the Franchise Tax Board's authority to use the information contained in the new-hire and contractor registries maintained by the Employment Development Department when collecting on Non-Tax Debt Programs administered by the Franchise Tax Board.
- Clarifies that a corporation's period of inactivity of 15 days or less between the date of incorporation and the beginning of its next annual accounting period would be disregarded as a taxable year.

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Laws and Legislation

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- Allows interest abatement on high-dollar erroneous refunds that are repaid in 30 days.
- Clarifies the operative date regarding a provision of recently enacted law that requires individual income tax returns prepared by certain tax practitioners to be e-filed with the Franchise Tax Board.

AB 1743 (Assembly Revenue and Taxation Committee) Stats. 2003, Chapt. 185

This code maintenance act corrects cross-references, repeals obsolete provisions contained in state law, and amends provisions to reflect the current style for drafting legislation.

SB 1061 (Senate Revenue & Taxation Committee) Stats. 2003, Chapt. 633

This act:

- Adds a definition of the term “taxable year” for California franchise tax purposes that was inadvertently repealed for taxable years beginning on or after January 1, 2000.
- Fundamentally reforms the water’s-edge election procedures to resolve problems that arise with elections made under the current contract rules. Under this act, water’s-edge elections would be made by statutory election rather than by contract.
- Eliminates inconsistencies between the Corporations Code and the Revenue and Taxation Code regarding the ability of a suspended corporation to apply for tax-exempt status.
- Allows exemption from taxation for specified limited liability companies.

SB 1065 (Senate Revenue & Taxation

Committee) Stats. 2003, Chapt. 486

This act mandates that federal tax elections made by a person prior to becoming a California taxpayer apply for California purposes.

Manufacturers’ Investment Credit

SB 1064 (Burton) Stats. 2003, Chapt. 606

This act clarifies that a taxpayer may not request a sales tax refund, in lieu of the Manufacturers’ Investment Credit (MIC), in excess of the amount of the MIC that could be applied to reduce the tax (or net tax) after first applying all other credits. It states that a MIC carryover credit may not be refunded until the year the MIC carryover can be applied to reduce the tax (or net tax).

Miscellaneous

AB 71 (Horton) Stats. 2003, Chapt. 890

This bill would allow the State Board of Equalization to:

- Create a Tobacco Tax Compliance Task Force that would include personnel from the Franchise Tax Board.
- Administer a statewide tobacco license program to regulate the sale of cigarette and tobacco products in California.

SB 157 (Bowen) Stats. 2003, Chapt. 702

Under this bill, one member of the Franchise Tax Board would serve on the Board of Governance, which would represent California on the multi-state sales and use tax project.

AB 243 (Vargas) Stats. 2003, Chapt. 428

Under the California Government Code, this act:

- Increases the maximum amount that may be allocated as a housing allowance from the gross salary of a

state-employed member of the clergy from 25 percent to 50 percent.

- Changes the term *minister of the gospel* to *member of the clergy*.
- Defines *member of the clergy* to mean a priest, minister, religious practitioner, or similar functionary of a religious denomination or religious organization.

SB 285 (Speier) Stats. 2003, Chapt. 370

This act provides that if an individual receives relief from income tax liabilities under the federal innocent spouse provisions, that individual would also receive relief under the state innocent spouse provisions.

SB 760 (Scott) Stats. 2003, Chapt. 597

This act extends a state and local sales and use tax exemption for specified sale and leaseback transactions of public passenger transportation vehicles.

This act requires the Franchise Tax Board to conduct a study on the impact of these sale and leaseback transactions to state income tax revenues.

SB 777 (Escutia) Stats. 2003, Chapt. 484

This act expands whistleblower protection laws to:

- Prohibit employers from taking retaliatory actions against employees who refuse to participate in illegal activities and impose a \$10,000 penalty on corporations and limited liability companies that violate this prohibition.
- Require the Attorney General to maintain a *whistleblower hotline* to receive information about illegal activity.

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Laws and Legislation

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State agencies

AB 385 (Nakano) Stats. 2003, Chapt. 433

This act allows a state agency to provide its employees, upon employee election, with an electronic itemized salary or wage statement in lieu of a statement in writing.

AB 986 (Horton) Stats. 2003, Chapt. 569

This act requires the Legislative Analyst to report to the Legislature regarding the merits of consolidating specific functions and operations of the Franchise Tax Board, the State Board of Equalization, and the Employment Development Department.

SB 25 (Bowen) Stats. 2003, Chapt. 907

This bill would remove the exemption for state and local agencies as a person or entity restricted from using social security numbers (SSNs). Specifically, this bill would prohibit a person or entity from:

- Publicly posting or displaying an individual's SSN.
 - Printing an individual's SSN on any card required to access products or services.
 - Requiring an individual to transmit his or her SSN over the Internet unless the connection is secure or the SSN is encrypted.
 - Requiring an individual to use his or her SSN to access an Internet Website unless a password or unique personal identification number is also required to access the Website.
 - Printing an individual's SSN on any materials that are mailed to the individual, unless state or federal law requires the SSN to be on the document to be mailed.
- Notwithstanding this provision, applications and forms sent by mail

may include SSNs.

SB 434 (Escutia) Stats. 2003, Chapt. 876

This bill would make declaratory of existing law certain provisions of the Government Code relating to investigations of unlawful activity by prosecuting attorneys or the Attorney General. This bill also would set forth rules relating to evidence, testimony, and subpoenaing of witnesses in conjunction with court actions or administrative hearings.

Tax forms

SB 448 (Poochigian) Stats. 2003, Chapt. 412

This act requires the Franchise Tax Board to include a voter registration card with the Personal Income Tax forms that are mailed annually to taxpayers.

SB 1009 (Alpert) Stats. 2003, Chapt. 718

This bill would allow persons to elect to report and remit qualified use tax on their income tax returns. The election could be made if the person purchases tangible personal property where the storage, use, or other consumption would subject the purchase to the qualified use tax that would otherwise be required to be reported and paid under current use tax law. The election under this bill would not apply to those taxpayers that are required to have a seller's permit or be registered with the State Board of Equalization.

Voluntary Contributions

AB 132 (Chavez) Stats. 2003, Chapt. 170

This act:

- Provides a statutory rule to prioritize the addition of voluntary contribution designations to the tax return.
- Authorizes us to add one or more voluntary contribution designations

to the tax return if it is determined that space is available.

AB 137 (Chavez) Stats. 2003, Chapt. 376

This act extends the *California Fund for Senior Citizens* contribution designation on the personal income tax return to January 1, 2010.

SB 43 (Cedillo) Stats. 2003, Chapt. 317

This act extends the *Emergency Food Assistance Program* Fund contribution designation on the personal income tax return to January 1, 2009.

SB 92 (Speier, et al) Stats. 2003, Chapt. 460

This act establishes the *California Missions Foundation Fund* for contribution designation on personal income tax returns.

SB 180 (Burton) Stats. 2003, Chapt. 189

This act changes the permissible uses for funds allocated to the *California Fire Foundation*.

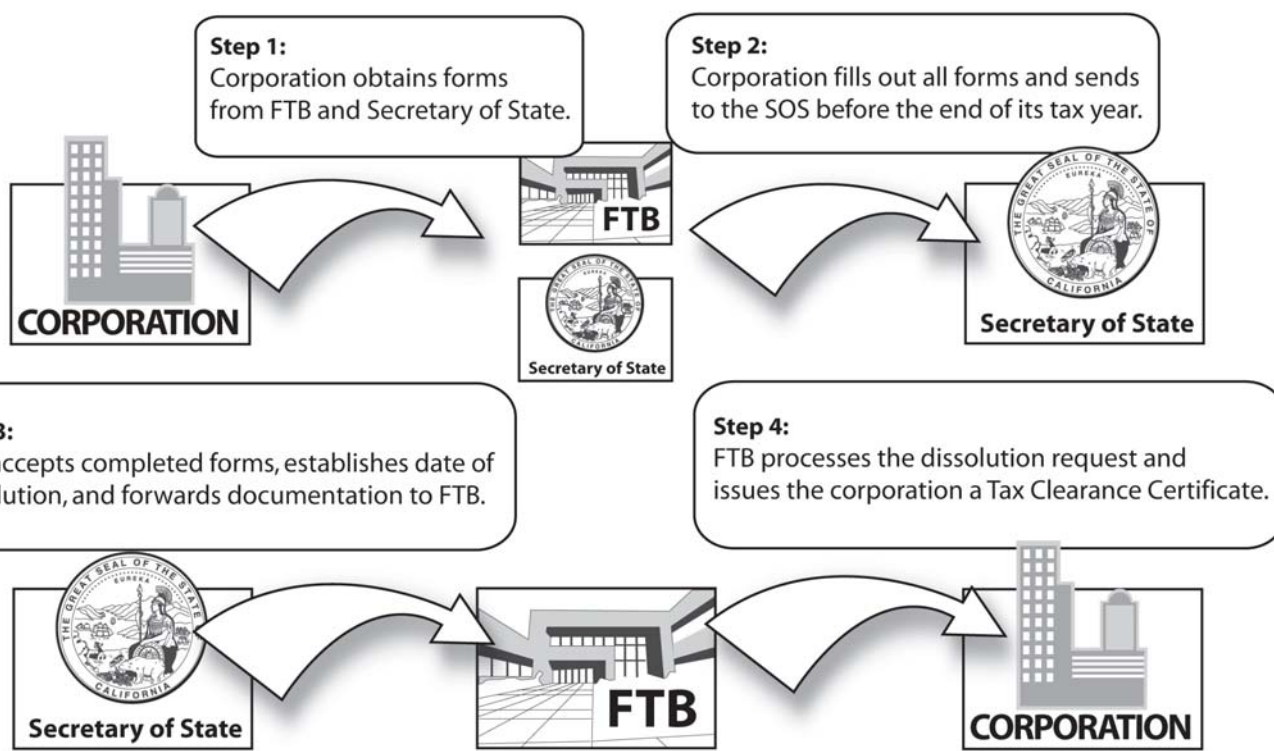
Holiday schedule

The Tax Practitioner Hotline is available Monday through Friday, 8 a.m. to 5 p.m.

The hotline is closed on weekends and state holidays. Here are the remaining state holidays we will observe in 2003:

- **Tuesday, November 11**
Veterans' Day
- **Thursday, November 27**
Thanksgiving Day
- **Friday, November 28**
Day after Thanksgiving
- **Thursday, December 25**
Christmas Day

How to Dissolve a California Domestic Corporation in 2003



For California domestic corporations that are organized through the California Secretary of State and planning to dissolve for the tax year ending in 2003, here are some suggestions that will make the process go smoothly.

Make sure you obtain *all* the proper forms and instructions. You can download or order forms and instructions from our Website, www.ftb.ca.gov and the Secretary of State Website (www.ss.ca.gov).

Complete all forms properly. If forms are missing, incomplete, or unsigned, the Secretary of State will return them to you for correction. As a result, the date of dissolution will not be established until you correct and resubmit all the forms.

HELPFUL HINT: If you are dissolving on the assumer basis, make sure that a qualified individual or other entity is listed on the *Assumption of Liability* form.

Next, mail all forms directly to the Secretary of State prior to the end of your tax year. The date the Secretary of State receives the completed forms will establish the date of dissolution and final tax year-end date. The Secretary of State

forwards all the required documents to us. Once we receive the documents we will process your request as soon as possible.

HELPFUL HINT: The quickest method to obtain a *Tax Clearance Certificate* is by dissolving on the assumer basis.

Finally, if your corporation is dissolving at the end of their normal tax year, timing is especially critical. You only have until your year-end plus fifteen days in order to be considered dissolved at the end of your normal business year. For example, if your normal tax year-end is December 31, you have until January 15 to submit correct forms to the Secretary of State. If the forms are received after January 15, you will be required to submit a short period tax return and pay no less than the minimum tax for the short period.

HELPFUL HINT: Mail forms early to allow extra time for any corrections of items that may have been omitted. Remember, the date of dissolution *IS NOT* the date you stopped conducting business. The date of dissolution is the day the Secretary of State receives a complete and correct request for dissolution.

DO YOUR PART...FILE SMART

Here is one way to reduce paper consumption and minimize waste

Reducing paper consumption is one the most effective ways to minimize waste. When taxpayers send us unnecessary attachments, particularly federal income tax returns, our cost to process their return increases. In 2002 alone, 1.8 million taxpayers unnecessarily attached their federal return to their California income tax return. Many attached a Form 1040 return to their Form 540 2EZ!

Processing tax returns containing unnecessary federal tax returns is a costly procedure, and so is processing those returns that lack the required federal tax return attached.

We received 600,000 such returns in 2002 and in many instances we had to contact taxpayers and request that they send us their federal income tax return.

Both problems are significant because of their extremely high volumes. Most of you already instruct your clients on what to send us when they file.

Please also explain to them how important it is to follow your instructions when they file, and to attach only **what we require from them**.

As a general reminder, here are some guidelines for when to attach federal returns to California personal income tax returns (for filing purposes):

When filing:	Attach Federal Return?
540 2 EZ	No
540 with Schedules And B only	No
540 NR (Short)	No
540A	No
540 with any other schedules other than A and B	Yes
540 NR (Long)	Yes

If special circumstances exist and you're not sure of what documentation your client needs to provide us, please check the filing instructions on the tax form. You can find all our forms and related instructions on our Website, www.ftb.ca.gov.

For a fail-proof way to ensure your clients are filing their returns properly, use e-file.

Avoid these common return preparation errors

Avoid these common errors when preparing returns and your clients returns will sail through our processing procedures.

Estimate payments

When the estimate payment total taxpayers claim on their return is different from the total we receive, we delay processing while we issue a notice about the discrepancy to the taxpayer. You can keep track of your clients' estimate payment activity by using the *Check Account Balance* feature on our Website, www.ftb.ca.gov. This application lets you view a record of the estimate payments we have received from your clients before you complete this step of the tax return.

You will need your clients' social security number and their customer service number in order to access their account information. You can obtain their customer service number from us if you can provide us with the appropriate *Franchise Tax Board Power of Attorney*, Form FTB 3520. To learn more about our Customer Service Number Program visit our *Customer Service Number Webpage*.

When adjusting estimate payment information on a scannable return, make sure you make the correction on both pages of the return. So, if you change the estimate payment total amount in

the scan band portion of the return, you must also change the total on Page 2 of the return or we will input the wrong amount.

Exemption credits

Be sure exemptions have been totaled correctly and that the total exemptions have been transferred to the correct line of the return.

Tax liability

Make sure all figures above the tax line have been reported correctly so the correct tax is computed.

Use the automated tax table on our Website and make sure you transfer the correct tax amount from the tax table to the tax return.

Excess State Disability Insurance claims

When reporting the amount of excess state disability insurance, make sure you only use the amount provided in the state disability insurance section of the client's form W-2.

For clients using the married filing joint filing status, be sure to calculate the primary taxpayer's and spouse's excess state disability insurance separately.

Do not include state disability insurance amounts from out-of-state sources in the total.

FTB makes changes to Schedule P instructions

Please note the following corrections to the 2002 California tax forms, instructions, and booklets. Should you have any questions about these clarifications, contact our Tax Forms Development and Distribution Section at (916) 845-3442.

2002 Instructions for Schedule P (540) Alternative Minimum Tax and Credit Limitations – Residents (53A)

The error appears on the instructions for the stand-alone form, “Page 6, Column 1, Part III, To complete Part III, 3rd bullet.”

The bullet asks that users complete line

17. However, it should direct users to complete line 12.

The bullet should read:

“If you have credit(s) in Section B, be sure to complete line 12 in addition to the line(s) for your credit(s).”

The error appears in the instructions for the stand-alone form (Page 6) and in Package X (Page 661). The Internet version is correct.

2002 Instructions for Schedule P (540NR) Alternative Minimum Tax and Credit Limitations – Nonresidents or Part-Year Residents (54A)

The error appears on the instructions for the stand-alone form, “Page 6, Column 2, Part III, To complete Part III, 3rd bullet.” The bullet asks that users complete line 17. However, it should direct users to complete line 12.

The bullet should read:

“If you have a credit(s) in Section B, be sure to complete line 12 in addition to the line(s) for your credit(s).”

The error appears in the instructions for the stand-alone form (Page 6) and in Package X (Page 672). The Internet version is correct.

Interest Rates

For the period of January 1, 2004, through June 30, 2004, the adjusted interest rate on underpayments and overpayments of California personal income taxes will be five percent.

The interest on corporation overpayments for the same period will be one percent. Here is an index of the interest rates for personal income taxes over the last 10 years.

Effective Date				Rate	Effective Date				Rate
1 Jan. 1993	to	30 June 1993		8%	1 Jan. 1999	to	30 June 1999		8%
1 July 1993	to	31 Dec. 1993		7%	1 July 1999	to	31 Dec. 1999		7%
1 Jan. 1994	to	30 June 1994		7%	1 Jan. 2000	to	30 June 2000		8%
1 July 1994	to	31 Dec. 1994		7%	1 July 2000	to	31 Dec. 2000		8%
1 Jan. 1995	to	30 June 1995		8%	1 Jan. 2001	to	30 June 2001		9%
1 July 1995	to	31 Dec. 1995		9%	1 July 2001	to	31 Dec. 2001		9%
1 Jan. 1996	to	30 June 1996		9%	1 Jan. 2002	to	30 June 2002		7%
1 July 1996	to	31 Dec. 1996		9%	1 July 2002	to	31 Dec. 2002		6%
1 Jan. 1997	to	30 June 1997		9%	1 Jan. 2003	to	30 June 2003		6%
1 July 1997	to	31 Dec. 1997		9%	1 July 2003	to	31 Dec. 2003		5%
1 Jan. 1998	to	30 June 1998		9%	1 Jan. 2004	to	30 June 2004		5 %
1 July 1998	to	31 Dec. 1998		9%					

Ensure that your 2003 substitute, scannable forms have FTB approval

If you are planning to use tax preparation software next year, be sure that the substitute and scannable California income tax forms generated from your software meet our Substitute Forms Program requirements.

All companies that manufacture and sell tax preparation software that generate substitute and scannable California income tax forms must file an agreement with us stating their intent to comply with our requirements for the 2003 tax year. By signing Form FTB 1096, *Agreement to Comply with FTB Publication 1098*, the company agrees to follow the rules for developing substitute and scannable forms.

Each year, tax software companies that produce substitute and scannable forms are required to submit their forms to us for approval before they are offered to their customers. If you are unsure whether the forms you plan to use this upcoming filing season have our approval, ask your software provider to

show you the FTB issued approval letter for each form you plan to use, **before** you use it. Do not accept a general statement from your provider that all company forms have been approved. Instead, give your software provider a list of the forms you plan to use and ask them to provide a copy of the FTB approval letter for each form.

Note: Companies that either sell or provide photocopies of official FTB income tax forms do not need to submit them for approval.

Filing tax returns on unapproved forms can lead to processing delays and in those cases where we can't process the tax returns we will have to contact your clients directly in an effort to process their tax returns.

By press time, the following software companies filed a form FTB 1096 with us.

5227 Tax System Inc.	800-578-1978
Accountware	513-841-4700
Alpine Data Inc.	800-525-1040
ATX Forms, Inc.	800-944-8883
CCH Incorporated	800-739-9998
Check Printers Inc.	904-421-4420
CPA Software	850-434-2685
Creative Solutions	800-968-5860
Dean Witter Realty	212-392-4601
Drake Software	828-524-8020
ExacTax	714-352-3638
EZ Tax Return.com	516-742-6767
File Your Taxes.com	805-984-0248
Gemsys Corp.	303-705-6000
Howard Soft	858-454-0121
Imageone	800-462-4366
Intuit	858-784-1545
KPMG LLP.	214-840-2529
Lamson Tech	215-925-0847
Nelco	920-337-1000
Orrtax Software	425-649-8291
RIA	800-327-8829
Stallion Software	513-936-9771
Tax Biz	408-243-1472
Tax Link Inc.	614-457-1949
Tax\$imple	800-989-8955
Vertex, Inc.(Arthur Anderson FL)	941-342-3674
Wilson LLP.	404-841-6251

2nd Story Software, Inc.	319-373-3600
Accountants World (Micro Vision Software)	800-829-7354
Basic Computer Services (Taxworks)	801-552-8800
Block Financial Corporation	617-491-1800
C & S Technologies Inc.	408-935-8449
CFS Tax Software Inc.	800-343-1157
Data Technology Group	315-493-6767
Deloitte & Touche	
Tax Technologies	800-394-3374
H&R Block Tax Services Inc.	816-714-2567
Jackson Hewitt Tax Services	941-379-7051
On-line Taxes Incorporated	816-232-0095
Petz Enterprises, Incorporated	209-835-2720
Probate Software	970-336-5960
Rhodes Computer Services Inc.	706-868-0985
SDDS Computer Accounting	909-987-2408
Smartrak Group, Inc.	763-559-2335
STF Services Corporation	800-541-7197
Tax Technologies Inc.	941-782-1210
Taxware Systems Inc.	909-931-3131
Tritech Software	
Development Corp.	800-380-6407
UDS Electrotax LLC.	410-730-8460
Universal Tax Systems, Incorporated	706-625-7757
William H. Downs, CPA	818-981-4313

Changes in information return reporting for 2003

Coverdell ESA contributions

Beginning with tax year 2003, use Form 5498-ESA, *Coverdell ESA Contribution Information*, to report clients' *Coverdell Education Saving Account* contributions. You can continue to use Form 5498, to report their Individual Retirement Arrangement contribution information.

Coverdell ESA distributions

Beginning with tax year 2003, use Form 1099-Q, *Payments From Qualified Education Programs (Under Sections*

529 and 530) to report Coverdell ESA distributions. Previously this was reported on Form 1099-R *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs Insurance Contracts, etc.*

Federal forms not required by California

The Internal Revenue Service has two new forms for information reporting. We do not require you to submit either when you file information returns

with us. They are:

- Form 1099-CAP, *Changes in Corporate Control and Capital Structure*.
- Form 1099-H, *Health Insurance Advance Payments*.

See the IRS Pub. 1220 for additional reporting and programming changes for 2003.

You may also look up information reporting on our Website, www.ftb.ca.gov, or call us at (916) 845-6304.

New schedule helps us keep track of withholding information

We now have a new form designed to save time during processing and help ensure that we do not destroy or misplace taxpayers' withholding information.

It is called the Schedule W, *California W-2 Attachment* and it works with our

scannable Forms 540 and 540A. You or your clients will attach paper copies of their form(s) W-2s, W-2Gs, 1099, 592-B, 594, and 597 to the Schedule W instead of attaching them to the face of the tax return.

Attention software developers: This new form will not have keying symbols, however, you will still need to obtain our approval prior to distributing it to your customers.

Pierce's Disease net operating loss deduction sunsets

The net operating loss deduction for the Pierce's Disease and its vectors sunsets for taxable years beginning after December 31, 2002. Net operating losses incurred for taxable years beginning on or

after January 1, 2001, and before January 1, 2003, may be carried forward, however the net operating loss deductions are suspended for taxable years beginning in 2002 and 2003.

Due to the suspension, we will not update the Form FTB 3805D, *Net Operating Loss Computation and Limitation - Pierce's Disease*, for the 2003 tax year.

Reduce errors by using scannable format for forms and vouchers

If you are aiming for an error-free filing season, we strongly urge you to use only the scannable version of Forms 540, 540A, 540-ES, 541-ES, and Forms FTB 3519, 3563 and 3582.

We also are encouraging software developers to discontinue production of the substitute version and to produce only scannable forms and vouchers. Scannable forms and vouchers:

- Are processed much faster and more efficiently than the substitute version.
- Have a minimal rate of operator fallout.
- Have a higher quality read rate.

Join e-file today

Now that e-file is mandatory for certain individual returns prepared by tax professionals, it is very important you know how to join the California e-file program.

Step 1: Enroll in the Internal Revenue Service e-file Program.

You need an IRS Electronic Filing Identification Number (EFIN) to enroll in our e-file Program. To receive your EFIN, visit the IRS Website at www.irs.gov, keyword EFIN.

Step 2: Enroll in our e-file Program.

Complete and submit our new online *California e-file Program Participant Enrollment Form* (FTB 8633). Click on the *e-file enrollment form* link or use keyword, *e-file enrollment*.

If you would prefer to fax or mail your enrollment form, you can use the paper versions also available at www.ftb.ca.gov. Use the fax number or address shown on the enrollment form.

Step 3: We process your enrollment form.

After we receive your enrollment form, we conduct a review of your account to ensure that all business entities are valid and licensed, all personal and business tax returns are filed timely, and all liabilities are current.

Step 4: We send you an acceptance letter.

When you have passed our review, we will issue your acceptance letter. In addition, we will provide you with a CD-ROM of e-file resources to guide you through the e-file process.

Step 5: e-file enrollment is complete.

When you receive your acceptance, you can begin e-filing returns.

We are available to assist you with your e-file questions and concerns. Our email



address is e-file@ftb.ca.gov. Or, you can call the e-file Programs Customer Service Unit at (916) 845-0353.

Online Secure Electronic Services

Don't waste your time waiting on the telephone to check on a refund, to verify estimate payments that have been made, or to confirm your client's balance due. Go to www.ftb.ca.gov and take advantage of our great services. Your client or you, as your client's authorized representative, can use these timesaving services 24 hours a day, seven days a week.

View Payments and Balance Due—With this service you can keep track of your client's Personal Income Tax account activity, obtain a tax year summary (tax computation) of your client's account, view payments applied to the account, and verify your client's estimated tax payments.

Are you tired of your clients receiving notices because the wrong amount of estimated tax payments was claimed on the return? You can avoid this problem by verifying your client's estimated tax payments prior to filing with our View Payments and Balance Due service.

Refund Status—Check the status of current year Personal Income Tax refunds for your clients or better yet direct them to www.ftb.ca.gov to check the status. It's easy, convenient, and accurate!

Make payments online with Web Pay—Web Pay is the fast, safe, and efficient way for your clients to pay their personal income taxes online. Web Pay electronically debits payments from

your client's bank account. With Web Pay, your clients can make the following types of payments online:

- Estimated tax
- Bill
- Return
- Extension

For more information on **Web Pay** or other online payment options, go to www.ftb.ca.gov and enter *payment options* in the search option.

Customer Service Number

Keeping taxpayer information private is one of our top concerns. In 2001 we implemented our Customer Service Number program as a way to authenticate the identity of taxpayers who do business directly with us. Taxpayers can use their customer service number in combination with their social security number to gain access to their private information online.

Your clients' customer service number is their key to many of the secure electronic services we provide on our Website. With their permission, it can be your key, too. These services can be powerful tools for evaluating and managing your clients' tax situation.

To learn how you can use our customer service number program to better serve your clients, visit our Customer Service Number Webpage, located on our Website, www.ftb.ca.gov.

Mandatory e-file update

e-file Opt-Out Record (Form FTB 8454)

California law requires individual income tax returns prepared by certain

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income tax preparers to be electronically filed (e-filed) unless the taxpayer elects not to e-file or the tax preparer cannot e-file the return due to reasonable cause. In response to your requests regarding recording mandatory e-file opt-outs, we developed the Form FTB 8454, *e-file Opt-Out Record*. Taxpayers may use this form to indicate their election not to e-file.

Tax preparers may also use it to record other reasons why a mandated return was not e-filed. This form should not be mailed to us or attached to the taxpayer's return. Retain this form and provide it to us only if we request it.

Our Website, www.ftb.ca.gov, is your best source for information about California's mandatory e-file. We are constantly updating the *Frequently Asked Questions* Webpage with answers to questions we receive. If you still have a question after reviewing our FAQs, please be sure to

contact our e-file Programs Customer Service Unit at (916) 845-0353.

Even though e-file (for affected tax practitioners) is now mandatory, some of your clients may be tentative about e-filing their return. You can help them by pointing out these benefits:

- Need money fast to pay a bill or to take a vacation?
- You can get your state refund in five to seven days with e-file! Avoid the eight-week delay of a paper filed return.
- Afraid there may be an error on your return?
- e-filed returns have an error rate of less than one percent while the error rate for paper returns is ten percent.
- Worried your return will be lost?
- When you e-file your return, the Franchise Tax Board sends you proof that they received it.
- Afraid your information will fall into the wrong hands?
- Choose e-file and your information goes from our (your tax preparer) computer to FTB.

Time to order your 2003 FTB Package X

We are now accepting orders for the 2003 California Package X. We will offer the printed version in bound and loose-leaf formats for \$17 plus sales tax.

If you subscribe to the print version of *Tax News*, you'll receive a personalized order form on the back of this issue. Use it to order your Package X and to renew your *Tax News* subscription. When completing the form be sure you:

- Use only the personalized 2003 order form provided on the back page of this issue. Do not use an order form from a previous year's issue. Using an outdated order form will delay your order, even if you cross out the year and write in 2003.
- Make any necessary corrections to your name and mailing address printed on the form.
- Provide your current telephone number.
- Add the amounts for your Package X and Tax News orders, and apply the appropriate amount of sales tax to the Package X order based on the county of your residence. To find the sales tax rate for your area, go to the California State Board of Equalization's Sales Tax Website, www.boe.ca.gov. Do not apply sales tax to the Tax News order amount.
- Be sure to enclose your check or money order, payable to the Franchise Tax Board. Orders without payments are not processed. Please do not send cash.

- Mail the order form and your check or money order to:
Package X/Tax News
PO Box 2708
Rancho Cordova CA 95741-2708.

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- First access the order form by going to our Website, www.ftb.ca.gov, and typing *Package X* in the search engine.
- Complete the order form. Follow the instructions provided. Be sure to add the amounts for your Package X and the Tax News orders, and apply the appropriate amount of sales tax to the Package X order based on where you live. Remember: Do not apply sales tax to the Tax News order amount.
- Click the submit button.
- Print the completed order form and mail it to us along with your check or money order.

For more information about ordering your 2003 Package X or subscribing to *Tax News*, visit our Website at www.ftb.ca.gov or call us at (916) 845-7070. **Remember:** You can always get up-to-date versions of all our forms and publications on our Website.